



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
SEPTEMBER 2002**

DATE: November 5, 2002

Approved

Date

The Monthly Financial Report (MFR) for September has been jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

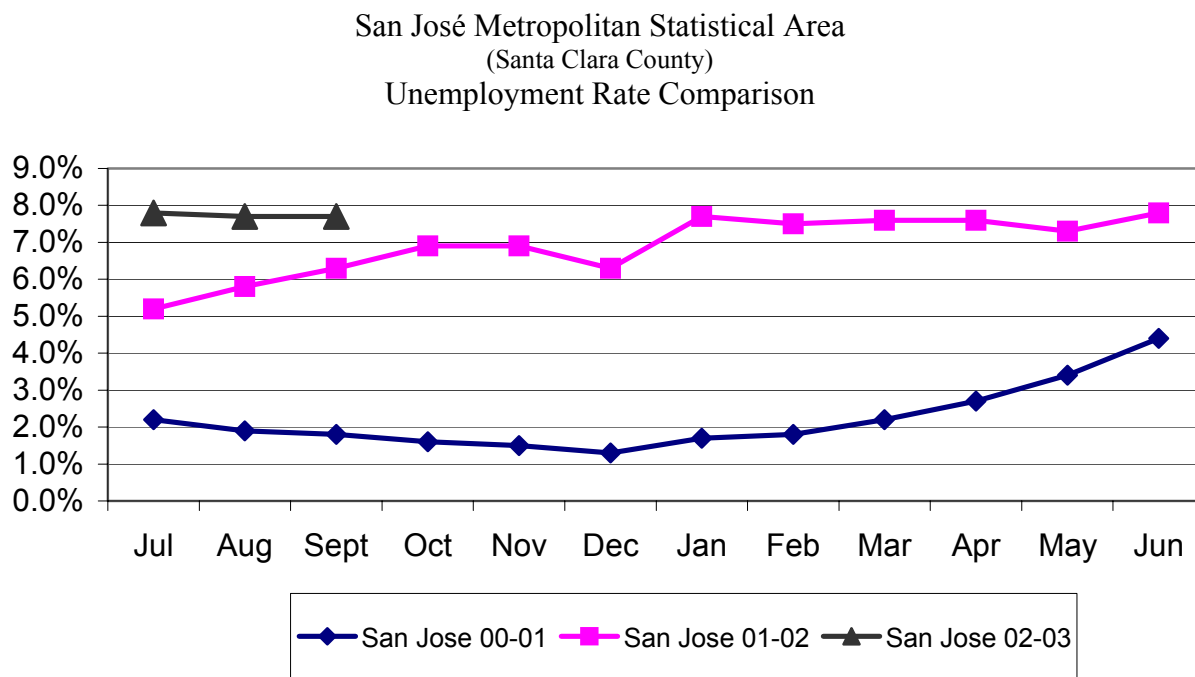
OVERVIEW

Through the first quarter, the City's finances continue to be negatively impacted by the current severe economic downturn. Most projections from both economists and local industries remain very pessimistic about the prospect for any short-term recovery in Silicon Valley.

Nationally a number of recent reports have created greater concern about the status of the fragile economic recovery that began last year. During the most recent quarter, the U.S. economy continued to grow, but at a slower than expected 3.1% annual rate, restrained by a wider trade deficit and decline in commercial construction. In fact, consumer spending during that period, most specifically strong new car sales spurred by zero interest financing, accounted for virtually all of that growth. This slower annual rate has created considerable concern about signs that consumers, who have virtually singlehandedly kept the economy growing in recent months, may have begun to reduce spending. Much lower growth is being forecasted for the current quarter. Job and war concerns continue to be big factors in the cautious approach of both business and now consumers. Jobless claims rose more than expected last week (410,000 from the previous week's 394,000) and wages and benefits grew in the third quarter at the slowest pace in three years. In recent weeks a number of large companies have announced fresh rounds of large job cuts (J. P. Morgan Chase, Sun Microsystems, Boeing, Corning), several right after reporting higher profits. The Conference Board's most recent consumer report also heightens the concerns about consumer strength, reporting that the consumer confidence index fell last month to a nine-year low.

The unemployment rate and the number of wage and salary jobs remain the strongest indicators of a very dismal local economic performance. The Santa Clara County unemployment rate remained at 7.7% through September, unchanged from the revised rate for August and above both the state and national rates reported at 6.1% and 5.4%, respectively. It is also worth noting that the September state and national rates were down slightly from August levels (6.2% and 5.7%, respectively).

OVERVIEW (CONT'D.)



Perhaps a more revealing indicator of economic trends in the Valley is the data contained in recent reports on the numbers of jobs in the County. Even while the unemployment rate has remained at the current elevated level for a few months, the number of jobs in the area has continued to decline. Wage and salary jobs in the County in September was estimated at 964,300, a drop of 4,100 from August's revised total of 960,200.

Reflecting these conditions, the City's economically sensitive revenues continue to show the impact of a local recession that is now in its second year. The most graphic example of that impact can be found in the City's most recent General Sales Tax report (representing the final quarter of the 2001-2002 fiscal year). Received in September, this quarterly payment reflected the fourth consecutive, quarterly, double-digit decline (first quarter of last year down 19.8%, second quarter down 18.2%, third quarter down 24.0%). A number of other City revenue sources have been similarly impacted. As a result of this performance and the review of final collection totals for last year, downward revenue adjustments to the 2002-2003 Adopted General Fund budget were recommended as part of the City Manager's 2001-2002 Annual Report. These downward adjustments of \$15.0 million were approved by the City Council in October.¹

As also discussed in the Annual Report, the current State Budget contained actions reducing City General Fund revenues by approximately \$1.0 million. The Annual Report actions also included

¹ The downward adjustments were offset by higher than anticipated year-ending fund balance, and unanticipated revenue that will be available from the sale of surplus property. These adjustments are not reflected in this Monthly Financial Report, as it covers financial performance through September.

OVERVIEW (CONT'D.)

adjustments to 2002-2003 revenue estimates to reflect that impact. We continue to be deeply concerned that the State will need to take additional budget balancing actions before the end of the year. Those actions could very well involve significant cuts to local government revenue sources (e.g., Motor Vehicle In-Lieu). We will continue to monitor the State budget situation very closely.

In keeping with the conservative fiscal practices that have served us so well in the past, the City Council and the Administration continue to put in place actions and processes designed to position the organization to withstand the significant fiscal challenges that clearly will confront the City during both the remainder of this year, and in preparation for the 2003-2004 fiscal year. As mentioned earlier, downward revisions to several General Fund revenue estimates to reflect current conditions were approved in the Annual Report, re-aligning the budget to our more current resource expectations. Also in the Annual Report, the City Council approved the establishment of an additional reserve for future deficits (\$11.7 million), to go along with the General Fund Contingency Reserve and the Reserve for Economic Uncertainty (\$15.7 million) established last fall, and not utilized during the recent budget process. In addition, as reported in the August MFR, at the beginning of September, all departments were notified by the City Manager that the hiring freeze in place since last November would continue indefinitely, and that cost/position management plan reduction targets had been assigned. All of the plans have been submitted and are now under review by the Budget Office.

The Administration will, of course, continue to monitor our financial position closely, and recommend additional actions as they appear necessary.

REVENUES

General Fund revenues through September 2002 totaled \$113.8 million. This was a decrease of \$7.2 million (down 6.0%) from the September 2001 level of \$121.0 million. The drop is somewhat overstated, however, due to one-time settlement revenue received last year from the County of Santa Clara. Excluding this prior year one-time revenue, the decline was approximately 1.5% (down \$1.7 million). This decline reflects decreases in the following revenue categories: Property Tax, Sales Tax, Transient Occupancy Tax, Use of Money and Property, Revenue from the State of California, Revenue from the Federal Government, and Other Revenue. Declines in those revenue categories were only partially offset by increases in the following revenue categories: Franchise Fees, Revenue from Local Agencies, Departmental Charges, and Transfers and Reimbursements.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

The following discussion highlights General Fund activities through September:

KEY GENERAL FUND REVENUES
(\$000's)

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Property Tax	\$ 86,278	\$ 319

Year-to-date Property Tax revenues reflected collections in only the smallest property tax category, SB 813 Property Taxes (supplemental taxes). In this category, payments of \$249,000 tracked 46.3% below last year's collection level of \$594,000. Collections in this category, representing payments for taxes owed on recent housing re-sales are typically a leading indicator of a drop in sales activities. Preliminary information from the County of Santa Clara indicates that the City should expect a significant decline and that the budgeted drop of 10.0% can be anticipated to occur. Consistent with previous years, no payments for Secured Property Taxes were received through August. Initial data from the County of Santa Clara does indicate, however, that growth should approximate the expected level for 2002-2003. Staff continues to work with the County to confirm the preliminary information for both SB 813 and Secured Property Taxes.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Sales Tax	\$ 148,849	\$ 12,643

General Sales Tax receipts for September represent only State formula-driven advance payments. General Sales Tax collections of \$11.7 million tracked 36.3% below the \$18.4 million collection in the prior year. Because these are advance payments, however, the decline through September is not necessarily indicative of the actual drop in receipts. As reported in the August MFR and the Annual Report, the City received during this period the most recent quarterly Sales Tax report from the State. It was evident from this report, reflecting collections during the final three months of last fiscal year, that the City's Sales Tax performance continues to be very weak, with a 16.7% decline from the same quarter last year, representing the fourth consecutive, double-digit, quarterly decline in General Sales Tax receipts. As a continuing reminder of just how hard hit this Valley has been, our decline was considerably greater than that experienced by both the San Francisco Bay Area (down 8.4%) and the State as a whole (down 1.4%).

A conservative estimate for a 25.0% drop was included in the year-end, fourth quarter accrual. While this latest General Sales Tax information does not change the 2001-2002 final collection recorded, the slightly improved performance at year-end does provide a small, one-time "buffer"

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Sales Tax (Cont'd.)	\$ 148,849	\$ 12,643

of \$3.1 million in 2002-2003 to help offset the impact of a continued, weakened, General Fund revenue situation. A downward adjustment to the 2002-2003 General Sales Tax estimate of \$11.4 million was approved by City Council as a part of the Annual Report, bringing that estimate in line with actual 2001-2002 collections and reducing expectations to a flat growth projection for the year.

Preliminary information from MBIA MuniServices, the City's Sales Tax consultants, indicates that the decline in the City's Sales Tax receipts for the most recent quarter can be attributed to poor performance in most economic sectors, but was led again, not surprisingly, by a sharp decline in the Business-to-Business category (down 35.2%). The following categories also suffered significant drops: Transportation (down 20.3%); Construction (down 6.5%); Food Products (down 6.4%); and General Retail (down 6.3%).

Specific areas within these economic categories are informative of General Sales Tax performance. Within the Business-to-Business category, the greatest declines were related to office equipment (down 37.7%), electronic equipment (down 35.8%), and light industry (down 47.7%). Within the Transportation sector, the greatest decline was in service stations (down 41.8%) and new auto sales (down 9.8%). The new auto sales decline is indicative of a softening trend over the prior years' phenomenal growth levels.² The following lists the largest General Sales Tax sectors and their percentage of the total for the 2001-2002 fourth quarter (March through June economic activity): Business-to-Business at 30.6%; General Retail at 24.4%; Transportation at 21.4%; Food Products 12.9%; and Construction at 9.9%.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transient Occupancy Tax	\$ 8,400	\$ 690

TOT collections of \$690,000 through September were well below last year's level of \$1.07 million. However, the drop is somewhat overstated, however, due to prior year accruals. Even adjusted for that factor, though, the decline through September performance is still a cause for

² For example, Motor Vehicle In-Lieu Fees 2001-2002 growth was 5.3% compared to the previous years: 9.8% growth in 2000-2001; 11.0% in 1999-2000; 9.5% growth in 1998-1999; and 10.0% growth in 1997-1998.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transient Occupancy Tax	\$ 8,400	\$ 690

concern. Excluding accruals, the decline was 15.0%. Performance of this tax has not rebounded significantly from the depressed levels suffered in the months following the immediate aftermath of the September 11 events, and collections continue to be sluggish into the current fiscal year. For example, the September occupancy rate was 51.9% below the August rate of 53.1% while the average room rate remained relatively flat (\$126.21 to \$126.10). The 2002-2003 Adopted Budget presumed growth in this revenue source (12.0%) over a higher than actually realized 2001-2002 collection level. Given current collection levels, it is very clear that the Adopted Budget level will not be achieved. As a result, a significant downward adjustment to the General Fund TOT estimate was recommended and approved by City Council in the Annual Report. Continued collections at the current level would necessitate a further downward reduction in this category. We will continue to monitor this situation very closely and recommend appropriate actions as part of the Mid-Year Budget Review.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Franchise Fees	\$ 33,857	\$ 5,807

Franchise Fees collections of \$5.8 million were above the September 2001 collection level of \$4.0 million. This positive variance primarily reflects higher collections in Electric and Gas Franchise Fees. It should be noted however, that these receipts are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in 2001-2002, and are not necessarily indicative of actual expected receipts. In April 2003, PG&E will calculate the actual Franchise Fees due in 2002-2003 based on calendar year 2002 activity. In addition, the September 2001 collection level was lower in part, due to an underpayment of Franchise Fees from PG&E in 2000-2001, which PG&E does not dispute. Collection of the underpayment from last year remains caught in the PG&E bankruptcy proceedings.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Franchise Fees (Cont'd.)	\$ 33,857	\$ 5,807

Commercial Solid Waste Franchise Fees of \$1.2 million were approximately 19.5% higher (\$192,000) than the prior year level of \$984,000. This positive performance is primarily due to the timing and booking of payments by the haulers and is also not necessarily indicative of actual expected receipts. Due to the 2001-2002 year-end performance of this Franchise Fee and current analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Utility Tax	\$ 70,673	\$ 12,498

Utility Tax collections of \$12.5 million were 1.7% (\$208,000) above last year's level of \$12.3 million. Due to the analysis of the 2001-2002 year-end performance, however, a downward adjustment to the current year estimate was proposed, and approved by City Council as part of the Annual Report. At the adjusted level, we expect to end the year within budget.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Licenses and Permits	\$ 62,459	\$ 14,712

Licenses and Permits revenue of \$14.7 million through September was less than one percent below the prior year level. As a result of our analysis of the prior year performance of the Disposal Facility Tax, however, a downward adjustment to the current year estimate was recommended and approved by City Council as part of the Annual Report.

Fire Permit revenues of close to \$1.99 million tracked below anticipated levels through September, although slightly above (1.5%) the prior year collection level of \$1.96 million. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Collections through September reflect activity levels that are well below that anticipated in the budget. These fees will continue to be

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Licenses and Permits (Cont'd.)	\$ 62,459	\$ 14,712

closely monitored and adjustments to the revenue estimate may be recommended as more information becomes available.

Building Permit revenues of \$3.8 million also tracked below (5.5%) anticipated levels, although 5.4% above last year's level of \$3.6 million. As with all revenue categories, these fees will continue to be closely monitored and adjustments to the revenue estimate, if appropriate, recommended as more information becomes available.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Fines, Forfeitures, and Penalties	\$ 11,076	\$ 2,220

Fines, Forfeitures, and Penalties revenue of \$2.2 million was 1.4% (\$31,000) above the prior year level. While the overall category performed as anticipated through September, revenue related to Parking Fines was 9.3% below the prior year collection level. Staff still expects this revenue category, including Parking Fines, to meet the budget estimate.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Use of Money and Property	\$ 13,095	\$ 2,327

As anticipated, the Use of Money and Property revenue of \$2.3 million was well below the prior year level of \$3.3 million, primarily due to lower cash balances in many funds, including the General Fund, and lower interest earnings for all funds. The General Fund cash balance for September was down to \$191.6 million, compared to the prior year's \$221.7 million, a decline of 13.6% (down \$30.1 million). The current budget for General Fund interest earnings was built anticipating a drop in the average cash balance for the year (to \$185.0 million). Staff will continue to monitor this revenue source closely to see how actual balances and earnings compare to the budgeted assumptions.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from Local Agencies	\$ 39,272	\$ 13,308

Revenue from Local Agencies of \$13.3 million was 16.5% (\$1.9 million) above the prior year level of \$11.4 million. This variance was primarily driven by several earlier than anticipated payments, including the following (indicating the variance in receipts versus expected levels): Community Based Aftercare Program funding from the County (\$450,000), payment from the County for the paramedic program (\$381,000), Cal-ID contributions (\$371,000), Enterprise Fund In-lieu (\$302,000), animal services payments from other agencies (\$200,000), and senior nutrition reimbursement from the County (\$94,000). No change in the budgeted revenue estimate is currently necessary.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from the State of California	\$ 58,204	\$ 8,580

Revenue from the State of California totaled \$8.6 million, representing a 21.8% decline from prior year collection level of \$11.0 million. The apparent decline primarily reflects the presence of a \$3.0 million accrual for open space activities, scheduled in 2001-2002 but yet to be paid, from Proposition 12 funds by the State.

This category includes Motor Vehicle In-Lieu Fee (MVLFF) payments of \$9.8 million, reflecting year-to-date growth of 3.1% (\$297,000). The City has since also received its October MVLFF payment from the State. That October payment of \$4.3 million was 15.6% above the prior year-to-date performance level of \$12.2 million. This performance does not necessarily indicate strong growth, but rather, reflects a combination of the significantly low prior year's October performance and the timing of deductions made by the State for Department of Motor Vehicles administrative fees. Staff will continue to monitor this revenue stream closely.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from the Federal Government	\$ 1,909	\$ (35)

Revenue from the Federal Government reflected negative accounting entries driven by accruals that were booked for anticipated revenue, including the following items: the Weed and Seed grant, a grant related to domestic violence, and Federal Emergency Management Agency funding for the Police Administration Building seismic retrofit. In addition, this category experienced lower than anticipated year-to-date receipts for grants related to the Metropolitan Medical Strike Team and COPS school-based partnerships. All budgeted grants are still expected to be received by year-end.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Departmental Charges		

-Public Works	\$ 6,356	\$ 1,279
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Public Works September revenues of \$1.3 million were 17.6% below the prior year level of \$1.6 million. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Collections through September reflect activity levels that are well below that anticipated in the budget. This performance reflects weak activity in the Residential Engineering, electrical design, and grading permit categories. This situation will require close monitoring since all of the Public Works Fee Reserve was exhausted to offset shortfalls in 2001-2002. The Budget Office will continue to work with the Department to project the year-end collection level, and contingency plans are under review should the lower than anticipated collection level continue.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
-Transportation	\$ 893	\$ 124

Transportation revenues of \$124,000 tracked below the prior year level of \$195,000. This performance was primarily driven by lower than anticipated development-related revenue activity (Residential Signal Review and Tree Plantings). Current projections indicate that this revenue source may end the year at lower than budgeted levels.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
-Library	\$ 812	\$ 206

Library revenues of \$206,000 were above the prior year level of \$164,000, but tracking within estimated levels. This performance was driven almost entirely by an increase in collections related to library fines. As circulation increases (e.g., the number of materials available such as books, videos, tapes, etc.), the amount collected for fines grows as well. This revenue source is still expected to meet the current budget estimate.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
-Planning	\$ 3,924	\$ 826

Planning revenues of \$826,000 tracked slightly below anticipated levels (down 3.0% or \$28,000). As with the other development-related revenue sources, current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Revenues received in all categories are either at or above anticipated levels, except for the Non-Residential area of PD rezonings/rezonings, environmental clearance reports, site developments, and conditional use permits. The Budget Office will continue to work with the Department to determine if any shortfall will result by year-end.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
-Parks, Recreation, and Neighborhood Services	\$ 6,946	\$ 3,233

Parks, Recreation, and Neighborhood Services (PRNS) revenues of \$3.2 million tracked 17.3% above the prior year level of \$2.4 million. This increase is almost entirely driven by growth in fee activities (\$761,000). This growth rate is likely not sustainable, but it is too early in the year to draw substantive conclusions regarding higher than budgeted collections. At this point, it is still assumed that this category will end the year at the budgeted level.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Other Revenue	\$ 14,495	\$ 3,991

Other Revenue collections of \$3.9 million were \$5.4 million below the prior year level of \$9.4 million. This decline from the prior year primarily reflects last year's booking of one-time settlement revenue from the County in the amount of \$5.5 million.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transfers and Reimbursements	\$ 66,021	\$ 30,229

Transfers and Reimbursement collections of \$30.2 million were 14.9% above the prior year level of \$26.3 million. This performance through September was primarily driven by higher levels of revenue from operating and capital/special fund overhead as well as earlier receipt of Municipal Water Rate of Return revenue.

EXPENDITURES

Through September, General Fund expenditures of \$157.6 million were 6.4% (\$9.5 million) above the prior year level of \$148.1 million. Encumbrances of \$70.6 million were 16.9% (\$10.2 million) above the prior year level of \$60.4 million. Expenditures and encumbrances (\$228.2 million) through September constitute 30.1% of the total 2002-2003 budgeted (as revised) use of funds (\$757.4 million, excluding reserves).

With the exception of the Fire Department, the Parks, Recreation, and Neighborhood Services (PRNS) Department, the Workers' Compensation Claims appropriation, and the City Insurance appropriation, individual and cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through September. Overtime expenditures are tracking above anticipated levels, however, in the following departments: Fire, Finance; General Services, General Services Parks Maintenance; Office of the City Clerk; Parks, Recreation, and Neighborhood Services; Planning, Building, and Code Enforcement; and Police. With the exception of Fire and PRNS, however, the departments are all currently generating sufficient salary savings to offset these higher overtime costs.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

The following discussion highlights General Fund expenditures:

KEY GENERAL FUND EXPENDITURES
(\$000's)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Police	\$ 216,504	\$ 44,101

Police Department overall expenditures were below estimated levels through September. The Department's Personal Services expenditures, however, tracked at slightly higher than expected levels, entirely due to increased overtime usage for Airport security activities. Additional reimbursements from the Airport will be brought forward during the Mid-Year Budget Review to fully cover the costs of increased Airport security-related expenditures.

With the continuation of the Sworn Recruitment and Training Program, a total of 38 recruits are currently enrolled in the July 2002 Academy and are expected to be street-ready in May 2003. Thirty-one graduates from the January 2002 Academy were street-ready last month (October 2002).

Overtime expenditures through September were above expected levels at \$2.1 million or 26.9% of the budgeted level (compared to the estimated level of 21.2%). It is expected, however, that with the exception of additional Police overtime currently being experienced at the Airport, the Department will manage its overtime to remain within the budgeted level by year-end.

The compensatory time balance at the end of September is 210,693 hours for sworn personnel, about the same level as the June 2002 balance of 210,724 hours. This level, however, represents an increase of 7,091 hours from the September 2001 balance of 203,602 hours.

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Fire	\$ 108,217	\$ 24,408

Overall, expenditures for the Fire Department continued to track significantly above budgeted levels in September. The Department's Personal Services expenditures are the problem, and are tracking at much higher than budgeted levels, reflecting the combined impact of a higher than needed non-paramedic firefighter count, and a change in the method of paramedic staffing deployment. The Department currently has a total of 192 filled front-line (119) and support (73)

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
Fire (Cont'd.)	\$ 108,217	\$ 24,408

paramedics, the highest level in the Department's history. The front-line total is, however, still 28 short of the 147 that are necessary to fully staff all apparatus. Last year, to address the paramedic staffing imbalance, and stay within their budget, the Department filled front-line paramedic duty requirements by deploying both front-line and support paramedic personnel. This process has been suspended since July to conduct an assessment of the impact of "dual role" practice. This suspension has, however, resulted in the Department's Personal Services tracking much higher than expected.

Should this situation continue through the rest of the year, we now project that the Department would exceed its Personal Services appropriation by as much as \$5.0 million. This shortfall would obviously be a major problem in a year in which the General Fund is already facing major difficulties. The City Manager's Office continues to work with the Department and the union to develop strategies to address both the short-term staffing issue and to develop long-term strategies to close the gap in front-line paramedics (e.g., accelerating the paramedic accreditation process, sending current Firefighters to Paramedic School, conducting Firefighter Paramedic Recruit Academies).

Current estimates indicate that the Department's level of Non-personal/Equipment expenditures are tracking at budgeted levels.

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
Parks, Recreation, and Neighborhood Services	\$ 108,217	\$ 24,408

PRNS Personal Services expenditures through September are tracking higher than anticipated (approximately 24.0%, compared to par level of 21.2%). In light of the relatively high level of vacancies in this department, the overage appears to reflect higher than budgeted expenditures for part-time staff and overtime to fill behind the vacant positions. The Budget Office is working with PRNS to assess what measures are needed to return both expenditures to budgeted levels, and achieve the savings required by the mandated cost/position management plan process (\$1.3 million). Non-personal/Equipment expenditures also appear higher than anticipated through

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
PRNS (Cont'd.)	\$ 108,217	\$ 24,408

September. This appears to be due, however, to two large expenditures that were incorrectly booked to PRNS's appropriations in September, but transferred to the appropriate City-Wide appropriations in October (Smart Start Centers at \$425,000 and Community-Based Aftercare Program at \$392,000). Departmental Non-personal/Equipment expenditures are expected to be within budgeted levels by year-end.

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
City-Wide Strategic Support	\$ 39,248	\$ 8,859

The City-Wide Strategic Support category includes funding for Workers' Compensation Claims and general City Insurance policy costs.

The City began to experience a spike in Worker's Compensation claims costs at the end of last year, and the 2001-2002 originally budgeted estimate was exceeded. Through September of this year, claims payments continued to track well above budgeted levels. Preliminary information indicates that the problem is not an increase in claims, but rather a significant increase in the cost per claim. For example, hospital payments increased 158% while expenses related to surgeons increased by 53%. In addition, physician and drug costs increased by 27%. Current Employee Services Department projections indicate a potential shortfall of between \$1.5 and \$2.5 million by year-end. An initial augmentation of \$500,000 to this appropriation was recommended and approved by City Council as part of the Annual Report. The Budget Office is working with the Employee Services Department to provide additional information and analysis, and will report the findings through the Monthly Financial Report process.

It now appears that the City Insurance appropriation will also experience a shortfall of approximately \$149,000 by year-end. In June 2002, the City Council approved a memo from the Finance Department detailing this possible gap. The Budget Office is currently working with the Finance Department to determine the extent of the issue and will bring forward appropriate adjustment recommendations during the Mid-Year Budget Review.

GENERAL FUND (CONT'D.)

CONTINGENCY RESERVE

Through September, the General Fund Contingency Reserve was down by \$62,500 from the 2002-2003 Adopted Budget level of \$24,549,175 (to \$24,486,675). The following revisions to the Contingency Reserve were approved through September:

- A decrease of \$27,500 to provide matching funds for an Office of Criminal Justice Planning "Domestic Violence" grant.
- A decrease of \$35,000 to provide for studies required to amend the General Plan related to the Almaden Youth Association Agreement.

OTHER FUNDS

Construction and Conveyance Tax Funds

Revenues for the Construction and Conveyance Tax Funds (C&C) are continuing to exceed expectations reflecting a local real estate market that has outperformed the rest of the economy. The number of property transfers for all types of residences in the first quarter of 2002-2003 totaled 2,525. This is a 19.8% increase from the first quarter of 2001-2002, which totaled 2,107. Nearly 97% of the total taxes received from C&C are comprised of Conveyance Receipts. Therefore, as Property Transfers increase, an increase in Conveyance can be expected as well.

Through September, \$4.2 million in actual tax revenues were received (26.3% of the 2002-2003 estimate of \$16.0 million). This collection is 7.4% higher than revenues received through September 2001. In addition to these revenues, the City has since received October Conveyance Tax receipts totaling \$1.9 million. The October amount is approximately 6.0% higher than the October 2001 amount of \$1.8 million. The 2002-2003 budgeted estimate was built anticipating a drop in real estate activity, allowing for a 39.0% decrease from the 2001-2002 collection level. This drop is higher than originally anticipated since collections in 2001-2002 significantly exceeded our expectations. While the news remains positive in this area, the prolonged economic downturn may still significantly impact housing sales. Therefore, we urge continued caution when interpreting the receipt results.

Other Construction-Related Revenues

After unusually strong receipts in August, construction-related tax revenues declined sharply in September. As a result, year-to-date receipts fell somewhat below receipts over the same period last year and are now coming closer to conservative budgeted estimates. The year-to-date total of the seven revenue sources monitored for this report is \$6.3 million, a decrease of 2.4% from the \$6.5 million collected through the same period last year. On an overall basis, this performance is still somewhat stronger than adopted budget estimates that allow for a 6.2% drop from the prior year. Staff and consultant analyses, however, indicate that because surplus

OTHER FUNDS (Cont'd.)

Other Construction-Related Revenues (Cont'd.)

capacity in industrial real estate is still so prevalent in San José, it is likely that construction-related taxes will demonstrate continued weak performance for a number of quarters to come.

The major revenue sources in this category (Building and Structure Construction Taxes and Construction Excise Taxes) dropped precipitously from August's collection levels. For example, Construction Excise Tax receipts for September totaled only 18.1% of the amounts collected the prior month. Year-to-date, Construction Excise Tax revenues equal \$3.6 million (26.3% of the current 2002-2003 estimate of \$13.66 million), representing a 1.9% decrease from last year's \$3.7 million received over the same period. The budgeted estimate for this category allows for an 8.2% drop in 2002-2003. Building and Structure Tax receipts through September totaled \$2.3 million (25.8% of the current 2002-2003 estimate of \$8.9 million), representing a decrease of 7.8% from the revenues collected through the same period last year (\$2.5 million). The budgeted estimate for this category allows for an 8.1% drop in 2002-2003.

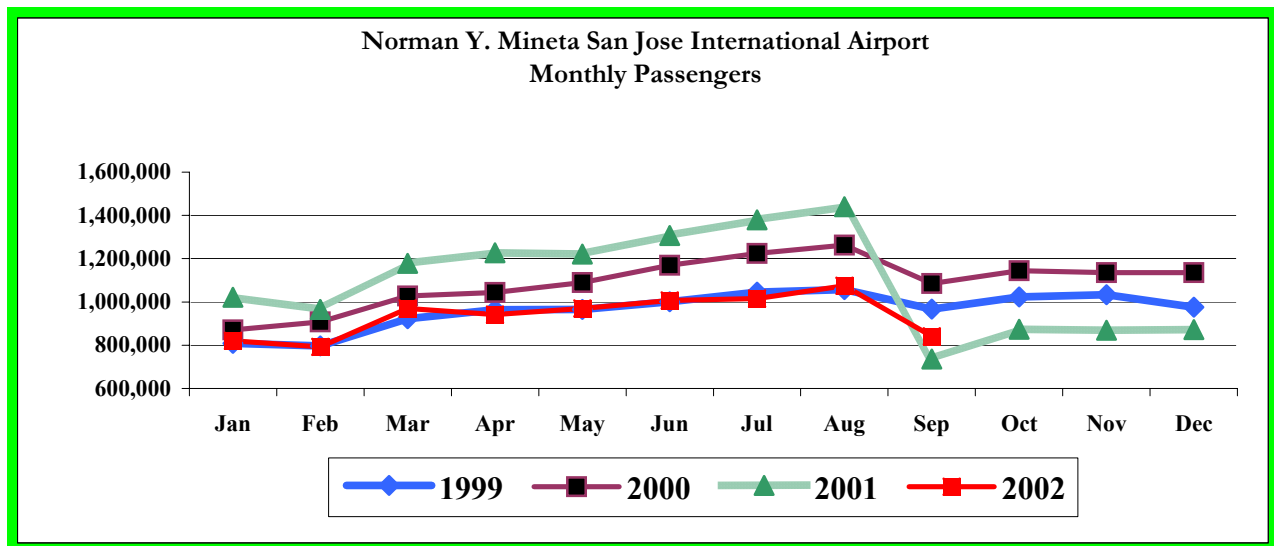
Among the smaller revenue categories, Sanitary Sewer Fees continued outperforming prior year data, while Residential Construction Taxes, Storm Drain, Major Facilities, and Service Connection Fees tracked below prior year collection patterns. Sanitary Sewer Fee receipts through September totaled \$291,000 (41.4% of the current 2002-2003 estimate of \$703,000), a level equal to nearly 180% of last year's \$162.3 million collected over the same period. In contrast, fee receipts through September for the Storm Drain Fees totaled \$94,000 (26.8% of the current 2002-2003 estimate of \$351,000), corresponding to 93.2% of the \$101,000 received over the same period last year. Residential Construction Tax receipts through September reached \$18,000 (11.7% of the current estimate of \$153,000), corresponding to only 35.8% of last year's receipts of \$50,000 through September. In the Water Utility Capital Program, Major Facilities Fee revenues through September totaled \$14,500 (5.8% of the current 2002-2003 estimate of \$250,000), representing a 21.7% decrease over the revenues collected through the same period last year (\$18,500). Service Connection Fee receipts through September were minimal, totaling only \$1,700 (0.5% of the current 2002-2003 estimate of \$320,000), 96.2% below collections through September 2001 (\$45,800). Because Service Connection Fee revenues recover actual costs to install new services, this revenue decline is coupled with a decline in costs, as well. Staff will continue to monitor these revenues closely.

Airport Funds

Through September 2002, the Norman Y. Mineta San José International Airport (SJC) enplaned and deplaned nearly 2.9 million passengers, which was 17.6% less than the prior year. For the month of September, the Airport served approximately 840,542 passengers; a 14.3% increase from September 2001 passenger activity levels. Terminal C passenger activity increased 17.4% in monthly comparisons, while activity for the fiscal year is lower by 16.7%. For Terminal A, September passenger activity increased by 12.7% and decreased by 18.0% for the fiscal year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)



Year-to-year comparisons were, of course, greatly impacted by the events of September 11, 2001, and major U.S. airlines continue the reduction of flight operations in response to the sharp declines in passenger activity. Recent Federal Aviation Administration projections indicate that it will likely take at least two years to return to the Year 2000 volume of passenger traffic.

Through September, American Airlines' levels decreased by 30.9% and Southwest was lower by 0.3% in fiscal year comparisons. Alaska and Northwest as well as two commuter airlines (Horizon Air and Skywest) were the only scheduled San José passenger carriers that experienced growth over last fiscal year. Skywest's fiscal year totals (+317.2%) continue to be greatly impacted by the airline's increased role as United's regional carrier to Los Angeles as part of the United's expanded Express service. Alaska and Northwest reported fiscal year increases of 0.6% and 17.7%, respectively, and Horizon saw an increase of 66.4%. American Trans Air launched its new daily, non-stop service to Chicago-Midway on October 1, and offers two daily flights using 195-passenger Boeing 757-200 aircraft. Beginning March 2003, American Airlines will offer a new daily, non-stop flight between SJC and Raleigh-Durham, North Carolina, on a Boeing 737-800 with seating for 20 first-class and 114 coach passengers.

Fiscal year-to-date mail, freight and cargo poundage totaled nearly 77.1 million pounds, a 1.3% decrease from 2001-2002. The decrease is largely attributed to a 56.7% reduction in mail and a 32.8% drop in freight. However, international cargo and domestic cargo posted a 16,276% and 6.4% increase, respectively, from the prior year. As reported last month, the overwhelming increase in international cargo activity continues to be somewhat skewed as one of the major cargo carriers had temporarily suspended enplaned international cargo for a brief period last fiscal year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)

Despite the reduced activity levels, overall revenue collections in the Airport Revenue Fund tracked at approximately the budgeted levels. The Airport continues to monitor all revenues and has developed contingency plans should any potential revenue shortfalls occur. First quarter revenues from the Airport Customer Facilities and Transportation Fee Fund, though, are currently at only 81.0% of the anticipated budget level. The Airport has established ongoing meetings with the rental car companies to communicate both activity levels as well as develop plans to meet service level needs.

As discussed previously, Airport Police overtime costs are anticipated to again exceed the current overtime allocation. The Airport and Police Departments are currently reviewing year-to-date overtime expenditures. It is anticipated that Airport funding will be recommended for allocation during the Mid-Year Budget Review process to fund the overtime costs.

The Airport Department operating fund expenditures through September, which includes the Airport Maintenance and Operation Fund and the Customer Facilities and Transportation Fee Fund, tracked slightly below budgeted levels in both Personal and Non-personal/Equipment Services. Through September, the Airport had 63 vacancies, of which 31 were defunded for 2002-2003. The remaining 32 positions are funded and five of these are currently backfilled. Through September, a total of 19 positions were exempted from the hiring freeze as these positions were deemed to be critical to customer service and/or the opening of the new Federal Inspection System building in mid-October. The Airport will continue to review all vacant positions on an administrative case-by-case basis in an effort to maximize cost savings while providing necessary services. Non-personal/Equipment expenditures through September, excluding encumbrances, totaled 14.3% of budget, and tracked slightly below anticipated levels. Encumbrances of \$16.1 million bring total non-personal/equipment services commitments to 49.1% of budget.

Transient Occupancy Tax Fund

TOT collections of \$1.07 million through September were well below last year's level of \$1.9 million. The drop is somewhat overstated, however, due to prior year accruals. But even adjusted for that factor, the decline through September performance is still cause for concern. Excluding accruals the decline was 15.0%. Performance of this tax has not rebounded significantly from the depressed levels suffered in the months following the immediate aftermath of the events, and collections have continued to be sluggish into the current fiscal year. For example, the September occupancy rate was 51.9% below the August rate of 53.1% while the average room rate remained relatively flat (\$126.21 to \$126.10). Given current collection levels, it is very clear that the Adopted Budget level will not be achieved. Due to the lower than expected 2001-2002 collection level of \$1.05 million, a reduction of \$262,740

OTHER FUNDS (Cont'd.)

Transient Occupancy Tax Fund (Cont'd.)

for the Convention and Visitor Bureau and the Arts Groups allocation was recommended and approved by City Council as part of the Annual Report, as was a reduction of \$525,420 to the Conventions, Arts, and Entertainment Department (CAE).

Given current collection levels, it is likely that a significant downward adjustment to the Adopted TOT Fund revenue estimate will need to be recommended and implemented during the Mid-Year Budget Review. This action would result in further significant decreases to TOT Fund revenue available for allocation to the three TOT Fund recipients. The potential impact could be as much as a \$1.3 million allocation decrease for CAE, as well as \$650,000 decreases for the Convention and Visitor Bureau and Arts Groups.

Unemployment Insurance Fund

Claims expenditures in the Unemployment Insurance Fund are now projected to end the year slightly over budgeted levels. Due to the high unemployment rate in Santa Clara County, combined with an increased benefit approved by the State effective at the beginning of the calendar year, expenditures are tracking above estimated levels. This fund will be monitored closely and a Mid-Year action possibly recommended.

CONCLUSION

While still early in the year, economic indicators and City revenue collections confirm that the severe local economic slowdown is continuing, with no immediate signs of any improvement.

Through prudent planning we have attempted to place the City in a relatively sound fiscal position. The latest examples of these efforts were the adjustments approved recently through the Annual Report. These adjustments included downward revisions to the City's revenue estimates which were indicated based on an analysis of last year's collections as well as the current year trends. The most prominent of these revisions involved the General Fund's largest revenue source – Sales Tax. In addition, a Reserve for 2003-2004 Deficit was established.

We will continue to monitor events closely, reporting monthly through this report. We will also bring recommendations for any additional adjustments that appear necessary or appropriate to either revenue or expenditure budgets to City Council through the Mid-year Budget Review.

LARRY D. LISENBEE
Budget Director